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No. 98-145

In the Supreme Court of the United States

OCTOBER TERM, 1997

BANKERS LIFE AND CASUALTY COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals applied the appropriate standard of judicial deference in reviewing the Treasury Regulation involved in this case.

2. Whether 26 C.F.R 1.815-2(b)(3) properly requires a stock life insurance company that distributes property to its shareholders to use the fair market value (instead of the adjusted basis) of the property in calculating adjustments to shareholder and policyholder surplus accounts pursuant to 26 U.S.C. 815.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A36) is reported at 142 F.3d 973. The opinion of the district court (Pet. App. A38-A62) is unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. A37) was entered on April 17, 1998. The petition for a writ of certiorari was filed on July 16, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a stock life insurance company subject to the three-phase taxation procedure of the Life Insurance Company Income Tax Act of 1959, Pub. L.

No. 86-69, 73 Stat. 112, as amended.[1] Under the 1959 Act, life insurance companies were allowed to defer taxation of one half of their underwriting income, defined as the amount by which their "gain from operations" for a particular year exceeded their "taxable investment income" for that year. 26 U.S.C. 802(b) (1982); see *United States* v. *Atlas Life Ins. Co.*, 381 U.S. 233, 235 & n.2 (1965). In connection with this deferral, stock life insurance companies were required to establish two special tax accounts: (i) a "shareholders surplus account" to reflect the portion of the company's income that had been subjected to tax after the 1959 Act went into effect (26 U.S.C. 815(b) (1982)) and (ii) a "policyholders surplus account" to reflect the portion of the underwriting income that had not yet been taxed (26 U.S.C. 815(c) (1982)).[2] To the extent that any distribution of cash or property was made to the shareholders of such companies in an amount in excess of the amounts previously added to the "shareholder's surplus account," the untaxed underwriting income reflected in the "policyholders surplus account" then

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[1] After 1983, the tax year at issue, the Tax Reform Act of 1984 (Division A of the Deficit Reduction Act of 1984), Pub. L. No. 98-369, Sections 211-224, 98 Stat. 494, 720-774, changed the federal income taxation of life insurance companies for tax years beginning after December 31, 1983. The 1984 Act generally eliminated the phase III deferral of income that existed under the 1959 Act for income earned after 1983. Life insurance companies were required, however, to maintain existing tax shareholder and policyholder surplus accounts reflecting the deferred income from prior years and to recognize such income when made available to shareholders through distributions. See 26 U.S.C. 815, as amended by Pub. L. No. 98-369, § 211(a), 98 Stat. 720.

[2] Although the principal components of these accounts are described in the text, the accounts also reflect additional items. See 26 U.S.C. 815(b), (c) (1982).

became subject to tax. See 26 U.S.C. 802(b)(3), 815(c); *Security Indus. Ins. Co.* v. *United States*, 702 F.2d 1234, 1240 (5th Cir. 1983).

In January 1961, following notice and comment procedures, the Treasury Department issued regulations to implement the provisions of the 1959 Act. The regulations were issued under the general authority granted to the Treasury to (26 U.S.C. 7805(a)):

> prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

The regulation involved in this case provides that, "[e]xcept in the case of a distribution in cash * * *, the amount to be charged to the special surplus accounts * * * with respect to any distributions to shareholders * * * shall be the fair market value of the property distributed, determined as of the date [of] the distribution." 26 C.F.R. 1.815-2(b)(3). As explained in the Technical Memorandum that accompanied the regulation, if adjusted basis rather than fair market value were used for this purpose, a company could make distributions of assets having a high fair market value and a low tax basis and thereby "deplet[e] its shareholder surplus account in a manner which ignores economic realities" (C.A. Supp. App. 52). "[B]ecause of this rather obvious method of avoiding triggering the phase 3 tax," the regulation adopted a fair market value rule that causes the shareholders surplus account to be depleted "at a rate which recognizes the true substance of the transaction" (*ibid.*).

In 1983, more than two decades after this regulation was promulgated, petitioner distributed to its sole

shareholder real estate and other non-cash assets with a fair market value in excess of $875,000,000 (Pet. App. A7). On its 1983 federal income tax return, in computing the subtractions from the company's surplus accounts pursuant to Section 815 of the Internal Revenue Code, petitioner complied with the regulation and reported the distributions at their fair market value (Pet. App. A48). By subtracting the $875,000,000 fair market value of the distributions from these accounts, petitioner's shareholders surplus account ($241,014,695) and its policyholders surplus account ($154,434,319) were both reduced to zero (*ibid.*). As the result, petitioner was required to include the entire amount of its policyholders surplus account in income (*ibid.*).

Petitioner paid the resulting tax and filed an administrative claim for refund. Petitioner contended that the adjusted basis of the property distributed, and not its fair market value, should be used in making the subtractions from surplus accounts under Section 815 (and therefore in determining whether there is income under Section 802(b)(3)) (Pet. App. A8, A48-A49). Because the property's adjusted basis ($209,650,747) was less than the amount of its shareholders surplus account ($241,014,695), petitioner asserted that there should be no subtraction from its policyholders surplus account and therefore sought a refund of $70,750,058 (*ibid.*). Petitioner acknowledged that its position was contrary to the agency's regulation but contended that the regulation was invalid (*ibid.*).

2. After the Internal Revenue Service disallowed the administrative claim for refund, petitioner brought this refund suit in district court. The district court sustained the challenged regulation and granted summary judgment in favor of the government (Pet. App. A9,

A45-A55). The court explained that petitioner's principal "contentions are founded upon a mischaracterization of the [shareholders surplus account] and the [policyholders surplus account] as asset holding accounts rather than" as "tax return memoranda accounts" employed for the special purpose of timing the recognition of deferred underwriting income under the 1959 Act (Pet. App. A55). The court concluded that "the government has adequately demonstrated that, given the unique treatment of income tax issues for life insurance companies under the Life Insurance Company Income Tax Act of 1959, the fair market [value] rule in [26 C.F.R.] 1.815-2(b)(3) is reasonable and harmonizes with the language, origin and purpose of section 815" (Pet. App. A55).

3. The court of appeals affirmed (Pet. App. A1-A36). The court stated that a Treasury regulation promulgated after notice and comment, such as the regulation involved in this case, is to be reviewed under the standard set forth in *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) (Pet. App. A10-A23). The court held that the regulation is valid under that standard because: (i) the plain language of the statute did not resolve the method of valuation to be used in measuring non-cash distributions from the policyholder and shareholder surplus accounts (*id.* at A33-A34) and (ii) "the government offer[ed] a reasonable explanation for the regulation given the origin and purpose of the three-phase taxation scheme" (*id.* at A36). The court concluded that petitioner's arguments purportedly based on "conventional taxation" are unavailing because Congress created a unique tax structure in enacting the three-phase tax procedure for life insurance companies (*id.* at A35). The court also rejected petitioner's contentions

that the regulation improperly created new taxable income, observing that "[t]he regulation merely provides the timing mechanism for the release of Phase III income [to taxation]" (*ibid.*). The court concluded that it was reasonable for the regulation "to limit the length of time the insurance company could defer Phase III taxes" and that the statutory "scheme evinces an intent to tax Phase III income upon large distributions to shareholders" (*id.* at A36).

ARGUMENT

The court of appeals correctly upheld the challenged regulation. No court has held to the contrary. Further review is therefore not warranted.

1. a. This Court has long made clear that the precise standard of judicial deference applicable to administrative interpretations and elaborations of statutory schemes varies with the nature and context of the agency's authority. For example, if "there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation," the agency's "legislative regulations" are to be "given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-844 (1984). When the agency's authority to interpret a statute is only implicit and general, rather than explicit and specific, the Court has stated that a lesser but still "considerable weight" is nonetheless to be accorded to the agency's interpretation and has emphasized that "a court may not substitute its own construction of a statutory provision for a reason-

able interpretation made by the administrator" (*id.* at 844).[3]

The interpretive regulations issued by the Treasury under 26 U.S.C. 7805(a) fall between these two standards. That statute provides the Treasury with a *general* but *explicit* authority to "prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." *Ibid.* Recognizing the broad nature of this delegation of authority to the Treasury, and the extraordinary complexity and interrelationship of the Code provisions, this Court has articulated a principle of great deference to regulations issued under this statute. The Court has consistently held that "Treasury Regulations 'must be sustained unless unreasonable and plainly inconsistent with the revenue statutes.'" *Commissioner* v. *Portland Cement Co.*, 450 U.S. 156, 169 (1981), quoting *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501 (1948). The Court has stressed that "[t]he choice among reasonable interpretations is for the Commissioner, not the

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[3] The Court has articulated a further and different standard for review of an agency's interpretation of its own legislative regulations. An administrative interpretation of a regulation is entitled to "controlling weight unless it is plainly erroneous or inconsistent with the regulation." *Udall* v. *Tallman*, 380 U.S. 1, 16-17 (1965), quoting *Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945). See also *Stinson* v. *United States*, 508 U.S. 36, 45 (1993). This standard of deference is particularly appropriate when the question of interpretation arises under "a complex and highly technical regulatory program" entailing "significant expertise, and * * * the exercise of judgment grounded in policy concerns." *Pauley* v. *BethEnergy Mines, Inc.*, 501 U.S. 680, 697 (1991).

courts." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 488 (1979). See also *Atlantic Mutual Ins. Co.* v. *Commissioner*, 118 S. Ct. 1413, 1418 (1998), citing *Cottage Savings Ass'n* v. *Commissioner*, 499 U.S. 554, 560-561 (1991).[4] Such heightened deference is afforded to the Treasury's interpretation of tax statutes because (*National Muffler Dealers Ass'n* v. *United States*, 440 U.S. at 477):

> "Congress has delegated to the * * * Commissioner * * * , not to the Courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U.S.C. § 7805(a)." *United States* v. *Correll*, 389 U.S., at 307. That delegation helps ensure that in "this area of limitless factual variations," *ibid.*, like cases will be treated alike. It also helps guarantee that the rules will be written by "masters of the subject," *United States* v. *Moore*, 95 U.S. 760, 763 (1878), who will be responsible for putting the rules into effect.

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[4] Petitioner incorrectly states that this Court concluded in *Atlantic Mutual Ins. Co.* v. *Commissioner*, *supra*, that "*Chevron* analysis applied to interpretive Treasury Regulations" (Pet. 8). In *Atlantic Mutual*, the Court cited *Chevron* only for the proposition that a regulation may not conflict with "the unambiguously expressed intent of Congress." 118 S. Ct. at 1417. Concluding that the statutory term involved in that case "is ambiguous," the Court then cited the traditional tax-deference standard in stating that "the task that confronts us is to decide, not whether the Treasury regulation represents the best interpretation of the statute, but whether it represents a reasonable one." *Id.* at 1418, citing *Cottage Savings Ass'n* v. *Commissioner*, 499 U.S. 554, 560-561 (1991)(citing *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. at 476-477).

b. The court of appeals concluded that the standard described by this Court in *Chevron*, rather than the standard that the Court has long applied to tax regulations in cases such as *National Muffler Dealers*, should apply in this case. In so holding, however, the court of appeals emphasized that it saw not even a "negligible" difference between the two standards and stated that "they both come down to one operative concept"—that the interpretive rules of the Treasury are to be sustained if reasonable (Pet. App. A20). Concluding that "the supposed gap between *Chevron* and the traditional rule [of cases such as *National Muffler Dealers*] is a distinction without a difference" (*ibid.*), the court of appeals elected to apply the standard of *Chevron* in this case out of a desire for "consistency" in administrative law (*id.* at A2).

For the reasons already described, however, the "consistency" to which the court of appeals aspires is more nuanced than the court recognized. Questions of administrative deference arise in distinct contexts—and the Court has elaborated distinct tests for those different contexts. See pages 6-7 & note 3, *supra*. The highly deferential standard of review that applies to the "needful rules and regulations" adopted by the Treasury under 26 U.S.C. 7805(a) is firmly grounded by this Court in the need for consistent application of the dauntingly complex provisions of the Internal Revenue Code and in the importance of administrative experience and expertise in achieving that goal. See *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. at 477. The Court has emphasized that it does not "sit as a committee of revision to perfect the administration of the tax laws" and that "[i]n this area of limitless factual variations, 'it is the province of Congress and the Commissioner, not the courts, to make the appropriate

adjustments.'" *United States* v. *Correll*, 389 U.S. 299, 306-307 (1967).

c. The question of the appropriate standard of deference for Treasury regulations is not, however, properly framed for review in this case. As the court of appeals emphasized (Pet. App. A21), it would be a rare case in which abstract disputes over the precise articulation of the standard of deference would actually control the proper disposition of a substantive tax controversy. And, as the court of appeals indicated, this is not such a case—the selection of the appropriate standard of deference here does not "make any difference" (*ibid.*).

Review is thus not warranted in this case because a judgment of this Court on the abstract issue of the appropriate standard of deference to Treasury regulations would not alter the ultimate disposition of the substantive controversy. This Court sits "to correct wrong judgments, not to revise opinions" (*Herb* v. *Pitcairn*, 324 U.S. 117, 126 (1945)).

2. a. The court of appeals correctly concluded that the challenged regulation reasonably implements the statute and should therefore be sustained (Pet. App. A34-A36). Section 1.815-2(b)(3) of the Treasury Regulations interprets Section 815 of the Internal Revenue Code (26 U.S.C. 815 (1982)), which governs the third phase of the three-phase taxation scheme for life insurance companies established by the Life Insurance Company Tax Act of 1959, Pub. L. No. 86-69, 73 Stat. 112. In general, Phases I and II of that tax scheme taxed a life insurance company's investment income and one half of its underwriting income in the current taxable year. 26 U.S.C. 802(b)(1) and (2), 804, 809 (1982); see *Security Indus. Ins. Co.* v. *United States*, 702 F.2d 1234, 1240 (5th Cir. 1983); S. Rep. No. 291,

86th Cong. 1st Sess. 20-21 (1959). Taxation of the remaining one half of the company's underwriting income was deferred and taxed at a later time under Phase III. 26 U.S.C. 802(b)(3).

To govern the timing of this deferred Phase III tax, Section 815 required a stock life insurance company to establish and maintain a "shareholders surplus account" to which the post-1957 income previously taxed under Phases I and II was added and a "policyholders surplus account" to which the untaxed post-1958 underwriting income was added. 26 U.S.C. 815(b), (c) (1982). See also note 2, *supra*. Under Section 815(a), "any distribution to shareholders" is to "be treated as made * * * first out of the shareholders surplus account" and "then out of the policyholders surplus account" (26 U.S.C. 815(a) (1982)). See also 26 U.S.C. 815(b)(3)(A), 815(c)(3)(A) (1982). To the extent that such distributions are treated as made from the policyholders surplus account, the deferred Phase III tax must then be recognized by the company. 26 U.S.C. 802(b)(3) (1982).

The proper valuation of a shareholder distribution of property is thus critical to the proper operation of this deferred tax system. Neither Section 815 nor any other provision of the Internal Revenue Code, however, specifies *how* shareholder distributions of non-cash property are to be valued in making the required adjustments to the shareholder and policyholder surplus accounts under Section 815 (and in thus implementing the Phase III deferred tax). As the court of appeals stated, "Congress failed to expressly provide a method of valuation" (Pet. App. A34). The challenged regulation fills this gap by providing that the fair market value of property distributed to shareholders is to be used in calculating the effect of such distributions on the shareholder and policyholder surplus accounts for

purposes of the Phase III deferred tax calculations (26 C.F.R. 1.815-2(b)(3)).

The agency's interpretation of the statute is plainly reasonable. The statutory deferral of the Phase III tax in the 1959 Act was premised on the view then held by Congress that the annual underwriting income of an insurance company (which required an estimate of expected future claims) was difficult to determine. S. Rep. No. 291, *supra*, at 6-7, 25-26; H.R. Rep. No. 34, 86th Cong., 1st Sess. 4, 15 (1959). The amounts accounted for in the policyholders surplus account—amounts on which no current tax was paid—were designed to serve as "'cushion' for special contingencies which may arise in the case of the policies involved." S. Rep. No. 291, *supra*, at 26. Congress did not, however, intend that the deferred half of a company's underwriting income should avoid taxation permanently. It was instead clearly intended that "underwriting gains *made available to shareholders* will be subject to the full payment of tax." S. Rep. No. 291, *supra*, at 13 (emphasis added); H.R. Rep. No. 34, *supra*, at 9 (emphasis added). See *United States* v. *Atlas Life Ins. Co.*, 381 U.S. 233, 235 n.2 (1965).[5] The House and Senate reports on the

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[5] An actual distribution to shareholders was only one of the circumstances that would cause the untaxed underwriting income reflected in the policyholders surplus account to become taxable under Phase III. For example, Section 815(d)(4) required a life insurance company to make a subtraction from its policyholders surplus account (and thus include the subtraction in income under Phase III) if the amount of the account exceeded certain percentages of company's reserves or current premium income. 26 U.S.C. 815(d)(4) (1982). The Phase III tax also became applicable when a company's status as an insurance company or a life insurance company terminated. 26 U.S.C. 815(d)(2)(A) (1982). See *Security Indus. Ins. Co.* v. *United States*, 702 F.2d at 1241.

1959 Act explained that "where a life insurance company has distributed dividends to stockholders which are in excess of the previously taxed income, it becomes clear that the company itself has made a determination that additional amounts constitute income which was not required to be retained to fulfill the policyholders' contracts." S. Rep. No. 291, *supra*, at 25; accord H.R. Rep. No. 34, *supra*, at 15. In that situation, the company has demonstrated by its actions that the amounts distributed are no longer needed as a "cushion" for contingencies and that they should therefore be subject to tax. S. Rep. No. 291, *supra*, at 26. See *Security Industrial Ins. Co.* v. *United States*, 702 F.2d at 1241.

The fair market value rule of the challenged Treasury regulation reasonably implements the legislative intent. When a life insurance company makes a distribution of property to its shareholders, the fair market value of that property is the amount that would otherwise have been available to meet policyholders' claims. In making such a distribution of property, the company has determined that it no longer needs to keep that surplus value on hand as a cushion against special contingencies. In that situation, it is thus appropriate to terminate the Phase III deferral of tax that was premised on the uncertainty of the availability of that surplus value. Any other rule would allow the company to continue to receive the benefit of the tax deferral on previously earned underwriting income while, at the same time, passing the value of that deferral on to its shareholders in the form of disposable property. Such a perpetual extension of the limited statutory tax deferral was plainly not intended by Congress. See S. Rep. No. 291, *supra*, at 13 ("The Phase 3 portion of the tax base is designed to give assurance that underwriting gains made available to shareholders will be

subject to the full payment of tax."). The regulation thus reasonably implements the limited deferral scheme of the statute.

b. Petitioner urges that it is only "*after* a court has * * * analyzed the context, design and structure of the statute, and only *after* it has concluded that Congress did not speak to the issue presented" that the court is to uphold a regulation as a reasonable implementation of the statute (Pet. 8). The decision of the court of appeals makes clear, however, that the court *did* consider the context, design and structure of the statute and, in doing so, properly rejected petitioner's contention that the challenged regulation conflicts with "the unambiguously expressed intent of Congress" (*Atlantic Mutual Ins. Co.* v. *Commissioner*, 118 S. Ct. at 1417, quoting *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. at 842-843).

The court began its discussion of the merits of the regulation "by parsing the language of the code section" involved (Pet. App. A25) and by looking to the specific words of the statute and their relationship to other Code provisions (*id.* at A26). The court then reviewed other provisions concerning accounting rules for tax credits and deferrals (*id.* at A27) and looked specifically to the legislative history contained in the House and Senate reports on the 1959 Act (*id.* at A28). The court also considered the need for "consistency throughout the tax code" (*ibid.*). Upon completing these inquiries, the court concluded that "the plain language of the statute simply fails to address the question of valuation" (*id.* at A34) and that, "while obviously some rule of valuation must be applied, Congress * * * failed expressly to provide one" (*ibid.*, quoting *Fulman* v. *United States*, 434 U.S. 528, 533 (1978)). Emphasizing that the history of the statute did not dictate any parti-

cular rule (Pet. App. A35), the court concluded that the regulation issued by the agency under 26 U.S.C. 7805(a) was "not unreasonable given the purpose of the statute" and therefore must be upheld (Pet. App. A36). Under the standard of deference described by this Court in *Chevron*, or the standard of deference that this Court has long applied in cases involving Treasury regulations (such as *National Muffler Dealers*), these findings and conclusions of the court of appeals provide a sufficient basis to sustain the agency's interpretation of the statute.

c. Addressing the merits of the regulation, petitioner urges that there are "several distinct" reasons to believe that, in enacting the 1959 Act, Congress evidenced an "intent that the adjusted tax basis" and not the fair market value of the property "be utilized for non-cash distributions under § 815" (Pet. 13-14). The court of appeals correctly rejected each of petitioner's specific arguments on the merits (Pet. App. A33-A36).

(i) Petitioner prominently relies upon its contention (Pet. 14-15) that distributed property should be valued at its basis (instead of its fair market value) because the statute specifies that distributions are to be treated as made "out of" the shareholders surplus account or policyholders surplus account (26 U.S.C. 815(a) (1982). See also 26 U.S.C. 815(b)(3)(A)(1982). Petitioner's effort to find dispositive meaning in this statutory snippet is unavailing. In the first place, the statute provides only that the property distribution is to be "treated as" if it were made "out of" the surplus accounts. *Ibid.* The statutory phrasing thus recognizes that a distribution cannot actually be made "out of" a shareholder or policyholder surplus account because such accounts are merely tax accounting mechanisms established to implement the Phase III tax under the

1959 Act. These surplus accounts are not depositories of any assets; they are simply records of previously taxed and previously deferred income. See 26 U.S.C. 815(b)(2), (c)(2) (1982). Moreover, the fact that a distribution is "treated as" being made "out of" an account does not provide any particular insight into the question of how such a distribution is to be *valued*. The "out of" language emphasized by petitioner merely indicates that the amount of the distribution reduces the amount of the account; it does not indicate what method is to be used to value the distribution. See *Fulman* v. *United States*, 434 U.S. at 534 (the phrase "out of * * * earnings and profits" in 26 U.S.C. 316 does not answer how a "distribution" is to be valued). The court of appeals thus correctly rejected petitioner's contention that this statutory phrasing is inconsistent with the method of valuation contained in the challenged regulation (Pet. App. A33-A34).

(ii) Contrary to petitioner's contention, nothing in the the "underlying statutory scheme" (Pet. 15) establishes that property distributions are to be valued for purposes of the Phase III tax on a basis other than their fair market value. By making a distribution of property to its shareholders, the company has demonstrated that it no longer needs the value of that property as a special contingency reserve. The underlying rationale for a temporary deferral of the tax on underwriting income thus no longer exists for the value of property that the company has voluntarily distributed to its shareholders. See page 12, *supra*. As the court of appeals stated, the underlying structure of the statute reflects that "the taxable event occurred when the life insurer earned the * * * income" and that the valuation of property dispositions merely determines when that "income [is] released from its special de-

ferred status" (Pet. App. A35). The underlying structure of the statute thus supports the agency's regulation.

(iii) Petitioner incorrectly contends that the statute "established a debits and credits tax accounting system" under which "debits and credits must be based on or reflect the same measure" (Pet. 14). Whatever relevance there might be to such an abstract contention, it overlooks the fact that the items recorded in the shareholder and policyholder surplus accounts under Section 815 pertain only to tax years beginning *after* December 31, 1957 (26 U.S.C. 815(b)(2), (c)(2) (1982)), while the adjusted basis of a company's assets reflects adjustments (such as depreciation) made both before and after that date. When an asset acquired *prior* to 1958 is distributed to shareholders, the basis of that asset has no connection whatever to the amounts reflected in the Section 815 surplus accounts. By establishing a system that includes only post-1957 items in the Section 815 surplus accounts, but which requires subtractions from those accounts whenever any asset (regardless of when acquired) is distributed after 1958, Congress obviously did not establish the type of precise "debits and credits" accounting system posited by petitioner.

Petitioner's related contention that "methods of conventional taxation * * * were embodied * * * in the Phase III [tax] system" (Pet. 16) is also clearly wrong. If "methods of conventional taxation" had been employed under this statute, there would have been no deferral of the company's underwriting income in Phase III in the first place. As this Court stated in *United States* v. *Consumer Life Insurance Co.*, 430 U.S. 725 (1977), the tax scheme at issue here gave "preferential tax treatment" to life insurance companies (430 U.S. at

728), and "[t]he major benefit [of that preferential tax treatment] [wa]s that only 50% of underwriting income is taxed in the year of receipt" (430 U.S. at 728 n.2). As the court of appeals explained in this case, "because of the singularity of the Phase III system, any conflicts with regular taxation do not mean very much" (Pet. App. A35).

(iv) Finally, petitioner argues that the court of appeals failed to honor two "cardinal principles that were embodied in the underwriting statutory structure and design" (Pet. 16). The first of these alleged cardinal principles is that the deferral need not end so long as "the deferred underlying income continued to be retained" (Pet. 15). Petitioner does not cite any statutory provisions or other indicia of congressional intent to support its assertion that this alleged "principle" was in any fashion embodied in the statute. In any event, as the facts of this case demonstrate, the rule in 26 C.F.R. 1.815-2(b)(3) is fully consistent with that principle. When petitioner distributed real estate and non-cash property worth more than $875,000,000, it distributed an amount that exceeded both the amount in the shareholders surplus account and the amount in the policyholders surplus account. See page 4, *supra*. As the result, there was no longer any deferred underwriting income acting "as a reserve or cushion against long-term contingencies" (Pet. 15). After the distribution, the property that formerly served as the "cushion" against special contingencies was in the hands of the shareholders, not the company. As the court of appeals correctly concluded, the regulation is consistent with the first of the two "cardinal principles" raised by petitioner (Pet. App. A32-A33).

Petitioner is also not assisted by the further "cardinal principle" that double-taxation is to be avoided (Pet.

15). The policyholders surplus account represents an account that records income that was deferred and "not taxed on a current basis" and that is instead subject to tax in Phase III. *Security Indus. Ins. Co.* v. *United States*, 702 F.2d at 1240. The challenged regulation does *not* impose a second tax on income that was previously taxed and does not tax items that were never intended to be taxed. Instead, as the court of appeals explained, "[t]he regulation merely provides the timing mechanism for the release of [previously earned] Phase III income * * * from its special deferred status" (Pet. App. A35). The second "cardinal principle" cited by petitioner is thus simply not implicated in this case.

d. There is no conflict among the lower courts concerning the validity of this 37-year old regulation. Each of the courts that has addressed the regulation has upheld it. Further review is therefore not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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